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Annette W. Jarvis, Utah Bar No. 1649
 RAY QUINNEY & NEBEKER P.C.
 36 South State Street, Suite 1400
 P.O. Box 45385
 Salt Lake City, Utah 84145-0385
 Telephone: (801) 532-1500
 Facsimile: (801) 532-7543
 Email: ajarvis@rqn.com

and

Lenard E. Schwartz
 Nevada Bar No. 0399
 Jeanette E. McPherson
 Nevada Bar No. 5423
 Schwartz & McPherson Law Firm
 2850 South Jones Boulevard, Suite 1
 Las Vegas, Nevada 89146-5308
 Telephone: (702) 228-7590
 Facsimile: (702) 892-0122
 E-Mail: bkfilings@s-mlaw.com

Proposed Attorneys for Debtors and Debtors-in-Possession

**UNITED STATES BANKRUPTCY COURT
 DISTRICT OF NEVADA**

In re:
 USA COMMERCIAL MORTGAGE COMPANY,
 Debtor.

In re:
 USA CAPITAL REALTY ADVISORS, LLC,
 Debtor.

In re:
 USA CAPITAL DIVERSIFIED TRUST DEED FUND, LLC,
 Debtor.

In re:
 USA CAPITAL FIRST TRUST DEED FUND, LLC,
 Debtor.

In re:
 USA SECURITIES, LLC,
 Debtor.

Affects:
☒ All Debtors
☐ USA Commercial Mortgage Company
☐ USA Securities, LLC
☐ USA Capital Realty Advisors, LLC
☐ USA Capital Diversified Trust Deed Fund, LLC
☐ USA First Trust Deed Fund, LLC

Case No. BK-S-06-10725 LBR
 Case No. BK-S-06-10726 LBR
 Case No. BK-S-06-10727 LBR
 Case No. BK-S-06-10728 LBR
 Case No. BK-S-06-10729 LBR

Chapter 11

**Jointly Administered Under
 Case No. BK-S-06-10725 LBR**

**REPLY BRIEF IN SUPPORT OF
 DEBTORS' MOTION FOR ORDER
 AUTHORIZING REIMBURSEMENT OF
 DUE DILIGENCE EXPENSES OF
 POTENTIAL POST-PETITION LENDER
 [AFFECTS ALL DEBTORS]**

Date: May 18, 2006
 Time: 9:30 a.m.

1 USA Commercial Mortgage Company (“USACM”), on behalf of itself and its affiliated
 2 debtors, USA Securities, LLC, USA Capital Realty Advisors, LLC, USA Capital Diversified Trust
 3 Deed Fund, LLC (“Diversified”), and USA Capital First Trust Deed Fund, LLC (“Capital First”)
 4 (collectively, the “Debtors”), submit this Reply Brief in support of the Debtors’ “Motion for Order
 5 Authorizing Reimbursement of Due Diligence Expenses of Potential Post-Petition Lender” (the
 6 “Due Diligence Expenses Motion” or the “Motion”), and also in reply to the objections to the
 7 Motion that have been filed.

8 INTRODUCTION

9 1. The Debtors filed this Motion in order to seek Court approval for the Debtors to
 10 provide a cash deposit (the “Deposit”) in the amount of \$150,000, to be applied by the proposed
 11 lender for the proposed post-petition loan (the “Post-Petition Loan”), Fortress Credit Corp.
 12 (“Fortress”), towards the actual expenses incurred or to be incurred by Fortress in completing due
 13 diligence for the potential Post-Petition Loan. It is the Debtors’ business judgment that the Deposit
 14 should be paid to Fortress to facilitate the anticipated Court approval and funding of the proposed
 15 Post-Petition Loan.

16 SUPPLEMENTAL FACTS AND ARGUMENT

17 2. As of April 13, 2006 (the “Petition Date”), USACM was acting as the loan servicer
 18 for approximately 115 separate loans (the “Serviced Loans”) having a combined outstanding loan
 19 balance of approximately \$962 million. See Exhibit A to the Supplemental Declaration of
 20 Thomas J. Allison dated May 2, 2006 that was e-filed with the Court on May 2, 2006 (Docket No.
 21 130).

22 3. There are approximately 3,600 investors (the “Direct Lenders”) whose names
 23 appear as a “Lender” in the loan documents for one or more of the Serviced Loans. Diversified
 24 and Capital First (collectively the “Funds”) are included among the Direct Lenders. See, Second
 25 Supplemental Declaration of Thomas J. Allison dated May 17, 2006 that is being e-filed with the
 26 Court contemporaneously with this Reply Brief (the “Second Supplemental Allison Declaration”)
 27 at ¶ 3. Capital First has approximately 1,300 members owning membership interests, and
 28 Diversified has approximately 1,900 members owning membership interests (collectively, the

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“Fund Members”). See, Second Supplemental Allison Declaration at ¶ 10.

4. The Debtors have determined in their business judgment that it is in the best interests of the Debtors to obtain post-petition, debtor-in-possession financing, for purposes of, among other things, assisting in the funding of the Debtors’ operational expenses and administrative expenses, given the number and magnitude of non-performing loans that must be collected, and providing a source of additional loan funds (if approved by the Court) for certain of the Serviced Loans where the funding to date for construction loans is less than the full construction budgets prepared by the Borrowers for the completed construction projects (the “Projects”) being built by such Borrowers (the “Construction Budget Shortfalls”) and where such funding is necessary or appropriate to maintaining and protecting the value of the collateral securing these certain Serviced Loans. See, Second Supplemental Allison Declaration at ¶ 11.

5. As a result of that business judgment, the Debtors negotiated with several debtor-in-possession lenders for a Post Petition Loan. The Debtors selected Fortress from among several other debtor-in-possession lenders as the lender from whom the Debtors should obtain a Post-Petition Loan (after Court approval) because the draft Term Sheet of Fortress was, in the Debtors’ business judgment, more favorable than those proposed by other debtor-in-possession lenders. See, Second Supplemental Allison Declaration at ¶ 12.

6. When the Due Diligence Expenses Motion was filed on May 8, 2006, the negotiations with Fortress were not yet completed. The parties anticipated that the terms in the draft Term Sheet that was under consideration at that time might change prior to the issuance of a firm commitment from Fortress, which was expected prior to the time the Due Diligence Expenses Motion was set for hearing. See, Second Supplemental Allison Declaration at ¶ 13.

7. A Commitment Letter (the “Commitment Letter”) signed by Fortress and dated May 12, 2006, has been delivered to the Debtors. As contemplated by the Due Diligence Expenses Motion, a copy of the Commitment Letter was attached as Exhibit “1” to the “Notice of Commitment Letter for DIP Financing” that was e-filed with the Court on May 16, 2006, as Docket No. 254. See, Second Supplemental Allison Declaration at ¶ 14. A true and correct additional copy of the Commitment Letter is also attached as Exhibit A to the Second

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Supplemental Allison Declaration.

8. During the Debtors' negotiations with Fortress, before Fortress was willing to commit additional time and resources to evaluating a potential Post-Petition Loan, Fortress stated that it would require that the Debtor agree (with Court approval) to reimburse Fortress for actual expenses (including Fortress's reasonable attorney fees) incurred by Fortress in connection with completion of due diligence and other matters associated with the potential Post-Petition Loan. Fortress has asked that the Debtors provide the Deposit in the amount of \$150,000, to be applied by Fortress toward actual expenses incurred or to be incurred in completing due diligence for the potential Post-Petition Loan. See, Second Supplemental Allison Declaration at ¶ 15. The amount of the Deposit was previously included in the Budget that was attached as Exhibit B to the Supplemental Declaration of Thomas Allison dated May 2, 2006 that was e-filed with the Court on May 2, 2006 (Docket No. 130). Indeed, while Fortress has delivered a Commitment Letter to the Debtors, the Commitment remains conditioned on the payment of the Deposit and the completion of due diligence (including legal due diligence) which the Deposit will allow for and facilitate. As set forth in the Commitment Letter, if the Deposit is not approved by the Court on May 18, 2006 and paid to Fortress by May 19, 2006, the Commitment Letter will terminate. See, Exhibit A to the Second Supplemental Allison Declaration.

9. It is the Debtors' business judgment that the payment of due diligence expenses to a debtor-in-possession lender is customary for debtor-in-possession financing transactions, and that the amount of the Deposit is a reasonable estimate of the amount of due diligence expenses that will reasonably be incurred by Fortress. See, Second Supplemental Allison Declaration at ¶ 17.

10. It is the Debtors' business judgment that there are at least three valid business reasons for obtaining the Post-Petition Loan for the Debtors: (a) Debtors may need additional sources of funds to pursue all necessary collection actions with respect to non-performing loans, given the number and amount of non-performing loans which are currently not generating cash to pay servicing fees to fund these actions; (b) Debtors may need additional liquidity to fund administrative and operational expenses in the event that the timing of payments on the Serviced

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Loans from which Debtors' servicing fees and other contractual costs and fees are deducted (and which the Court has approved as funding sources) are irregular and/or disrupted and do not match the funding requirements for the timely payment of Debtors' administrative and operational expenses; and (c) Debtors need a source of funding for additional loans to the Borrowers with Construction Budget Shortfalls to allow such Borrowers to complete their Construction Projects if the Debtors determine that additional funding is necessary or appropriate to preserve value of the underlying collateral for the Serviced Loans for the Direct Lenders, the Funds, the Fund Members, and USACM and such funding is then approved by the Court. See, Second Supplemental Allison Declaration at ¶ 18.

11. The Debtors are engaged in various critical tasks that must be accomplished in order to analyze and safeguard the interests of all Direct Lenders (including the interests of the Funds as Direct Lenders) and Fund Members. See, Second Supplemental Allison Declaration at ¶ 19-21, 23.

12. The Debtors' Revised Budget (the "Budget"), which was attached as Exhibit B to the Supplemental Declaration of Thomas J. Allison that was e-filed on May 2, 2006 (Docket No. 130), outlines the Budget that the Debtors have prepared for payment of the administrative costs and collection costs that must be undertaken by the Debtors to preserve and increase value for the Debtors, the Direct Lenders, and the Fund Members. However, the Budget only contemplated the appointment of one creditors committee for the five Debtors, so it is possible that the professional fees associated with payment for counsel to the four committees that were just appointed by the United States Trustee will be even higher than those contemplated by the Budget, requiring additional sources of funds for the Debtors to operate in Chapter 11. See, Second Supplemental Allison Declaration at ¶ 24.

13. If the Court approves the payment of the Deposit, the Deposit will be paid from the sources outlined in and in accordance with the Budget. The Debtors are not asking that other funds being held by the Debtors be used to pay the Deposit, but only that the Deposit be paid from those funding sources outlined in the Budget and previously approved by the Court. See, Second Supplemental Allison Declaration at ¶ 25.

14. As of the Petition Date, approximately 62 of the Serviced Loans were delinquent in the payment of interest or otherwise could be considered non-performing (the “Nonperforming Loans”). The Nonperforming Loans represent 72% percent in outstanding loan balance of the Serviced Loans. See Second Supplemental Allison Declaration at ¶ 4.

15. The Debtors have initiated measures for collecting unpaid interest on the Nonperforming Loans, as well as implementing improved loan servicing procedures. However, even with these operational changes, the regular payment streams of payments being made to USACM as Servicer of the Serviced Loans have been disrupted because of the filing of the bankruptcy petitions for the Debtors. Moreover, interest is not being paid on a regular basis on the large number of Nonperforming Loans. Therefore, the Debtors cannot currently count on a regular stream of payments being made to USACM as Servicer from which the servicing fees and other contractual costs and fees that will be used to fund the Budget will be deducted. See Second Supplemental Allison Declaration at ¶ 26.

16. The Debtors are in need of additional liquidity in the form of the Post-Petition Loan in order to be able to timely pay their administrative expenses and operational expenses as they are incurred on a regular basis, as contemplated by the Budget. To the extent that there are insufficient funds on hand on any particular date from the funds which the Court has authorized the Debtors to use for payment of administrative and operational expenses incurred to collect unpaid interest and principal on the Serviced Loans, the Debtors can draw on the Post-Petition Loan in order to cover any such insufficiency. See Second Supplemental Allison Declaration at ¶ 27.

17. Attached as Exhibit B to the Second Supplemental Allison Declaration is a list prepared by Mesirow of thirty (30) of the Serviced Loans which have Construction Budget Shortfalls. The amount of the Construction Budget Shortfall for each of these 30 Serviced Loans (the “Shortfall Loans”) is listed on Exhibit B to the Second Supplemental Allison Declaration. The total amount of the Construction Budget Shortfalls is \$73,122,216. See Second Supplemental Allison Declaration at ¶ 28.

18. It is the Debtors’ understanding that the Borrowers for the Shortfall Loans

1 requested loan funding for only a portion of the construction budgets for their various Projects
 2 because they wanted to avoid having to pay interest from the inception of the Shortfall Loans on
 3 the full amount of the loan funds needed to cover their entire construction budgets for their
 4 completed Projects. It is the Debtors' understanding that the Borrowers for the Shortfall Loans are
 5 planning to build their Projects in stages, and are looking to obtain additional loan funding for the
 6 future stages of their Projects from USACM. See, Second Supplemental Allison Declaration at ¶
 7 29.

8 19. The Projects for which the Shortfall Loans are being used for construction purposes
 9 are not completed Projects. It is the Debtors' business judgment that most, if not all, of the
 10 Borrowers for the Shortfall Loans will need additional loan funding of up to the amount of the
 11 Construction Budget Shortfalls for each Shortfall Loan in order to complete their Projects. See,
 12 Second Supplemental Allison Declaration at ¶ 30.

13 20. It is the Debtors' business judgment that the value of the collateral for the Shortfall
 14 Loans will be preserved and greatly enhanced for the benefit of the Direct Lenders, the Funds, the
 15 Fund Members, and the Debtors if the Projects can be completed as contemplated by their
 16 Borrowers. A completed construction project that is a candidate for a sale to an investor or a take-
 17 out loan from a permanent financing source is much more likely to generate the funds needed to
 18 pay off the Shortfall Loans in full than an uncompleted construction project that is likely to be
 19 encumbered with mechanic's liens and embroiled in other litigation. See, Second Supplemental
 20 Allison Declaration at ¶ 31.

21 21. It is the Debtors' belief that USAMC does not have the obligation, but has the right,
 22 with Court approval, to fund additional loan funds in the amount of the Construction Budget
 23 Shortfalls for each of the Shortfall Loans. It is the Debtors' business judgment that USAMC
 24 should seek Court approval (in connection with the Court approval of the Post-Petition Loan) to
 25 use some of the proceeds from the Post-Petition Loan to fund the Construction Budget Shortfalls
 26 for most, if not all, of the Shortfall Loans. USAMC will make its determination whether or not to
 27 seek Court approval to fund a particular Construction Budget Shortfall from the Post-Petition
 28 Loan based upon appraisals and other customary due diligence lending standards to be applied by

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the Debtor to each Shortfall Loan and each Project, including whether or not the particular Shortfall Loan is a Nonperforming Loan. See, Second Supplemental Allison Declaration at ¶ 32.

23. USACM has filed a Motion seeking authority to engage an outside appraisal firm to evaluate all of the real estate collateral securing the Serviced Loans. These appraisals will assist USACM in its due diligence determination whether or not to fund a particular Construction Budget Shortfall for a particular Project. See, Second Supplemental Allison Declaration at ¶ 33.

24. In its Limited Opposition to the Motion, the Official Committee of Equity Security Holders of USA Capital First Trust Deed Fund, LLC (the “First Trust Deed Committee”) objected to the Motion because of the Committee’s contention that the Debtors had not yet articulated a sound business justification for paying the due diligence expenses of Fortress. The Canepa Group’s Opposition to the Motion also contends that the Motion lacks sufficient evidentiary and legal support. The Debtors respectfully submit that the foregoing supplemental statement of facts, accompanied by the filed Second Supplemental Allison Declaration, provide the requisite evidentiary basis for the Debtors’ statement in the Motion that it is their business judgment that obtaining debtor-in-possession financing will be beneficial to the bankruptcy estates of the Debtors and to all parties in interest. The foregoing sound business justifications support the Debtors’ need for the payment of the Deposit so that Fortress can complete its due diligence and a motion to approve the Post-Petition Loan can be filed and noticed and set for hearing.

25. The First Trust Deed Committee also objected to the Motion because the Debtors had not yet identified the terms and conditions of the proposed Post-Petition Loan. The Fortress Commitment Letter is now on file with the Court, and is attached to the Second Supplemental Allison Declaration. The Debtors are not asking that the Deposit be paid in a vacuum, and submit that the Court can now determine, based upon the reasons outlined above, that the payment of the Deposit “makes sense.”

26. The Canepa Group has also objected to the Motion. The Canepa Group incorrectly contends that counsel for the Debtors verbally requested at the May 3, 2006 hearing approval of a \$50,000 advance on the Deposit, and that this Court denied such verbal request. This is not correct. Counsel for the Debtors at the May 3, 2006 hearing explained that the \$150,000 Deposit

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amount was included in the Budget that was being considered at the May 3, 2006 hearing, similar to the professional fees that are also included in the Budget, but that both would be subject to further Court approval. The Debtors did not ask for pre-approval of those professional fees, but just explained that they were included in the Budget for informational purposes. Similarly, the Debtors did not ask for pre-approval of the Deposit, but just explained that the Deposit was included in the Budget for informational purposes, and would be requested to be authorized by separate Motion in the future upon Court approval.

27. The Canepa Group also argues that the Motion is premature. The Second Supplemental Allison Declaration amply demonstrates the critical and urgent need for the Post-Petition Loan now. The Canepa Group suggests that protracted litigation may be needed in order to sort out the consequences of the Debtors' pre-petition activities. The Debtors are hopeful that such protracted litigation will not be needed, and that the Direct Lenders and Fund Members will recognize that the actions being taken by the Debtors are intended to preserve value for the Direct Lenders and Fund Members as well as the Debtors. In any event, the Debtors simply cannot wait for every detail of the Debtor's pre-petition conduct to be examined and sorted out. The need for a Post-Petition Loan is immediate and the consequences for the Debtors, and indeed for all Direct Lenders and Fund Members, if they do not have adequate funds could be dire.

28. The Canepa Group contends that USACM is not in compliance with NRS 645B.175. The Canepa Group evidently objects to the Debtors' request that the Court authorize USAMC to hold the Serviced Loan repayment funds being received by USACM until the hearing before the Court on July 25, 2006, to allow the Debtors to sort out and report to the Court on any overpayments that any of the Direct Lenders may have received before the Petition Date. This is a matter that has been noticed up for hearing on June 2, 2006. It is not necessary for the Court to address this issue in the context of this motion.

29. In any case, the Debtors assert that they are in full compliance with NRS 645B.175. The Debtors assert that USAMC's payment obligations are governed by Nevada Revised Statutes 645B.175, Subsection 9, which provides: "9. If a mortgage broker or a mortgage agent receives any money pursuant to this section, the mortgage broker or mortgage agent, after the deduction

1 and payment of any fee or service charge due the mortgage broker, shall not release the money to:
 2 (a) Any person who does not have a contractual or legal right to receive the money; or (b) Any
 3 person who has a contractual right to receive the money if the mortgage broker or mortgage agent
 4 knows or, in light of all the surrounding facts and circumstances, reasonably should know that the
 5 person's contractual right to receive the money violates any provision of this chapter or a
 6 regulation adopted pursuant to this chapter."

7 30. The Debtors assert that USAMC may not be allowed under the governing Nevada
 8 statute to make payments to any Direct Lenders unless and until USAMC can determine that such
 9 Direct Lender has not been overpaid prior to the Petition Date the amounts that such Direct Lender
 10 was contractually and legally entitled to receive. The Debtors contend that until USAMC can
 11 make this determination, which it plans to be able to make by July 25, 2006, the governing
 12 Nevada statute prohibits USAMC from making payments to any Direct Lenders.

13 31. The Serviced Loan repayments that USAMC is receiving from the Borrowers are
 14 being held in a separate bank account established by USAMC, and the Debtors are keeping
 15 accurate accounting records to account for such loan repayments on a Serviced Loan by Serviced
 16 Loan basis. The servicing fees and other contractual fees and costs that the Court has authorized
 17 to be used by the Debtors are being deducted from these loan repayments and are being deposited
 18 into a separate Debtor-in-Possession bank account, and are not being commingled with the net
 19 Serviced Loan repayments that are held in a separate account. See, Second Supplemental Allison
 20 Declaration at ¶ 34. Again, The Debtors assert that they are in full compliance with all
 21 requirements of NRS 645B.175.

22 CONCLUSION

23 The Debtors clearly have demonstrated that there is a sound business justification for
 24 payment of the Deposit in order to induce Fortress to complete its due diligence and proceed
 25 forward with the filing of a motion to approve the anticipated Post-Petition Loan. The payment of
 26 the Deposit is well within the sound discretion of the Debtors' business judgment, and they have
 27 exercised that business judgment by requesting that the Court approve the payment of the Deposit.
 28 The Debtors have provided an ample evidentiary and legal basis for granting the Motion. The

1 Debtors respectfully request that the Limited Opposition of the First Trust Deed Committee and
2 the Opposition of the Canepa Group be overruled, and that the Motion be granted.

3 Respectfully submitted on May 17, 2006.
4

5 /s/ Jeanette E. McPherson

6 Lenard E. Schwartzter, Esq.

7 Jeanette E. McPherson, Esq.

8 SCHWARTZER & MCPHERSON LAW FIRM

9 2850 South Jones Boulevard, Suite 1

10 Las Vegas, Nevada 89146

11 Proposed Attorneys for Debtors

12 and Debtors-in-Possession
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2850 South Jones Boulevard, Suite 1
Las Vegas, Nevada 89146-5308
Tel: (702) 228-7590 · Fax: (702) 892-0122